Narragansett Electric Company

Docket 2930

Earned Savings Proof

Testimony of

Frank W. Radigan

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Rhode Island Public Utilities Commission
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Submitted by:
The Energy Council of Rhode Island

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS

A. My name is Frank W. Radigan. I am a principal in the Hudson River Energy Group, a consulting firm providing services to the electric utility industry and specializing in the fields of rates, planning and utility economics. My office address is One Steuben Place, Suite 508, Albany, New York 12207.

Q. PLEASE SUMMARIZE YOUR EDUCATION AND BUSINESS EXPERIENCE.

A. I received my engineering degree from Clarkson College of Technology in Potsdam, New York (now Clarkson University) in 1981. I received a Certificate in Regulatory Economics from the State University of New York at Albany in 1990. From 1981 until February 1997, I served on the Staff of the New York State Department of Public Service in the Rates and System Planning Sections of the Power Division. My responsibilities included the analysis of rates and tariffs of electric and steam utilities in the State and encompassed rate design and performing embedded and marginal cost of service studies. Before leaving the Commission, I was responsible for directing all engineering staff during major rate proceedings. In February 1997, I left the Department and joined a firm called Louis Berger & Associates as a Senior Energy Consultant. In December of 1998, I formed my own company. In my twenty-two years of experience, I have testified as an expert witness in utility rate proceedings on more than thirty occasions before the New York Public Service

Commission, the New York Department of Taxation and Finance, the Rhode Island Public Utilities Commission and the Federal Energy Regulatory Commission.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am submitting this testimony on behalf of The Energy Council of Rhode Island (TEC-RI). TEC-RI is a non-profit energy consortium, comprised of approximately 65 companies – manufacturers, businesses and institutions. These companies are the major employers, universities and companies headquartered in Rhode Island. They are the economic backbone of the State. TEC-RI was founded in the early 1980s with the goal of achieving least-cost, more efficient energy by working with utility companies and the State's energy regulatory agencies. TEC-RI's goal is to obtain competitive energy rates in Rhode Island. Those energy rates currently are well above the national average

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of the testimony is to address the reasonableness of the Narragansett Electric Company's (the Company's) proposed Earned Savings Proof as filed in this

Docket and its implications for the overall reasonableness of the Company's distribution rates.

Q. PLEASE COMMENT ON THE OVERALL REASONABLENESS OF THE COMPANY'S DISTRIBUTION RATES?

A. As noted in Section 8 of the Settlement governing Narragansett's rates, properly structured incentive rates should align the interests of the utility and its ratepayers. The Savings Proof formula alone does not indicate what a true cost of service would be if all components of the Company's rates and revenue requirement were examined. It does, however, give an indication of the overall reasonableness of the outcome of the incentive rate structure. In addition, as terms of the Settlement also require that the Company file other key financial data (weather normalized sales, actual cost of service and over earnings balances), Narragansett's filing provides many indicators of the overall reasonableness of the Settlement.

A review of this filing indicates that the Settlement excessively favors the Company to the detriment of ratepayers. The level of annual operating cost savings of $17.0 million, $15.3 million in overearnings that eventually must be returned to ratepayers, and unexpectedly high sales growth which has added $12.6 million annually to

Narragansett's retail revenues all indicate that the $13.1 rate reduction included in the Settlement was inadequate. At the same time, TEC-RI members have found that there is no effective competitive choice in supply, and most are tethered to the company through the standard offer. For customers taking power under the standard offer, the total unit cost (delivery and supply) has increased by 22% since the settlement was signed. This situation is even worse under last resort service. In all, the data shows that the Settlement has not aligned the interests of the utility and its customers. This misalignment is so great that TEC-RI urges the Commission to reassess the Settlement in its entirety, and initiate a new proceeding to examine all aspects of Narragansett's delivery charges and customer supply options.

Q. PLEASE COMMENT ON THE COMPANY'S FINANCIAL DATA.

A. The first financial indicator is the overall level of the Savings Proof. The savings determination formula is the methodology established in the Settlement for quantifying merger related savings to be shared between the Company and its customers. The earned savings amount that the Company eventually will be allowed to build into its rates is based on this methodology. The updated filing made by the Company on September 22, 2003, shows a net cost savings of $17.0 million, with ratepayers and the Company sharing half of that amount ($8.5 million). The savings go directly to the utility's bottom line.

The inadequacy of the Settlement rate reduction is evident by the fact that the Company has reduced expenses considerably more than the $13.1 million rate reduction implemented in March 2000. For a utility with distribution revenues of roughly $215 million, the cost savings of $17.0 million annually equates to roughly 8% of total revenues. If rates are reset, the terms of the Settlement allow the company to charge 50% of the cost savings as an expense. Even so, the ratepayer share of the cost savings ($8.5 million) in and of itself indicates that the overall benefits of the Settlement should be re-examined.

Q. PLEASE COMMENT ON OTHER FINANCIAL PARAMETERS.

A. The Company's savings proof shows that sales growth in the utility's service territory has been brisk. Before weather normalization, the Company had sales growth of almost 6% in the two-year period since the Settlement was signed. Using the Company's methodology for pricing sales, this sales growth equates to increased annual revenues of $12.6 million. As such, sales growth alone has almost eliminated the impact to the utility's net income of the $13.1 million rate reduction that began in the spring of 2000.

Q. PLEASE CONTINUE DISCUSSING THE COMPANY'S FINANCIAL PERFORMANCE.

A. Pursuant to Section 11 of the Settlement, the Settlement sets forth a 50/50 sharing of earnings from 150 to 250 basis points above the Company's allowed rate of return of 10.5%. Earnings of more that 250 basis points above the allowed return are shared between customers (75%) and the Company (25%). In response to an August 4, 2003 letter by the Rhode Island Department of Attorney General, the Company disclosed that the excess earnings amount owed to customers is $15.3 million as of June 30, 2003. The response correctly noted that the terms of the Settlement do not require any crediting of the overearnings until after December 31, 2004. As such, the overearnings balance currently serves as an interest free ratepayer loan to Narragansett. While crediting should eventually occur under the Settlement, the accumulated excess earnings due to date is further evidence that the Settlement failed to establish a reasonable balance of shareholder and consumer interests.

Q. PLEASE COMMENT ON THE BENEFITS THAT THE RATEPAYERS HAVE SEEN UNDER THE TERMS OF THE SETTLEMENT.

A. At the time the Settlement was signed, the rates for customers taking service under Service Class No. G-62, average were as follows:

Total Delivery Charges	3.4 cents/kWh
Standard Offer	<u>3.8</u> cents/kWh
Total Charge	7.2 cents/kWh.

Since that time, there has been a slight decrease in the transition component of the Delivery Charge that has been overwhelmed by a substantial increase in the Standard Offer. As a result, today, this same customer is paying an average rate of 8.8 cents/kWh, or 22% <u>more</u> than when the Settlement was signed. This level of increase in the bills its members pay does not indicate a proper alignment of the interests of the parties. Moreover, given the fact that Last Resort Service is priced even higher than Standard Offer Service, the sad fact is that the Standard Offer is the best that ratepayers can expect. The financial data available and the rates that customers actually pay indicate that the Settlement and the structure of the electric rate in Rhode Island should be revisited.

Q. WHAT COMPONENTS OF NARRAGANSETT'S RATES SHOULD BE REVISTED?

A. The Commission should review all revenue requirement components used to establish base delivery rates; reassess complete rate unbundling and revenue neutral rate design changes consistent with the results of the cost of service study that will be filed in 2004; and re-examine customer choice supply options. To date, the only viable options for getting supply are the Standard Offer or a price quote from a supplier in the open market. There are a limited number of energy service suppliers in NEPOOL, none that do not know what the Standard Offer is, and most act as both ESCOs and suppliers of the Standard Offer – thereby preventing real competition in prices. Thus, there are insufficient market participants, and pricing is pegged to the Standard Offer rather than market dynamics. TEC-RI believes that what is really needed is a comprehensive review of the supply options and the services supplied by the delivery company. This can include, but not be limited to, fixed rate price options, variable price options, supply options by service classification, load factor or time-of-use, ESCO supply options, and hedging options run by the company at the behest of its customers; in short, genuine customer choice. This need for true customer choice is so critical, the Commission should not wait not wait until 2004 when the new cost of service study is scheduled to be filed, rather the Commission should begin the process immediately.

Q. WHAT ARE YOUR RECOMMENDATIONS TO THE SAVINGS PROOF?

A. I propose one adjustment to the Company's presentation that decreases the actual cost of service. This adjustment relates to the company's accounting practice of allocating the costs of the Niagara Mohawk-National Grid merger to the companies within the National Grid holding company structure. While the Company claims that this rate treatment is consistent with the treatment of the transaction costs of the National Grid – Narragansett merger, what is not clear is whether Rhode Island ratepayers will garner any benefit from the merger of what is essentially a Massachusetts utility with a New York utility. Until such time that it is proven that there are tangible benefits to Rhode Island consumers and those benefits exceed the cost to realize it (in Narragansett's rates), no recognition of this expense should be allowed.

Under the savings proof formula in the Settlement, this adjustment would also increase the savings from $17.0 million to $17.4 million. Under the terms of the Settlement, when distribution rates are reset, the Company could claim that it could keep 50% of the savings associated with it as an expense in future rates. This, however, would be a myopic reading, unless the Commission is certain that the benefits received by customers exceed not only the savings share but also the $4.7 million in expenses that that Company is trying to charge customers. Thus, no change to the savings proof should be allowed until such time a showing is made. This elimination of expense also impacts the overearnings balance. The Company booked over $4.7 million in expenses to Narragansett in 2002 (and presumably did so since the merger in 2001, and continues to do so). I estimate this has increased expense by a cumulative $10.6 million. Had this expense not been charged, the company's earnings would have increased, as would the overearnings balance. I estimate that the overearnings balance would be $5.2 million higher had the company not charged this expense to Narragansett**.** Thus, for ratemaking purposes the overearnings balance should be increased from $15.3 million to $20.5 million.

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Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes.